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No. 99-579

In the Supreme Court of the United States

HARRIS TRUST AND SAVINGS BANK, ETC., ET AL.,
PETITIONERS

v.

SALOMON BROTHERS, INC., ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONERS

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QUESTION PRESENTED

Whether a civil action under Section 502(a)(3) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1132(a)(3), to obtain "appropriate equitable relief" to "redress" any "act or practice which violates" Title I of ERISA, may be brought to obtain restitution from a nonfiduciary party in interest that engaged in a transaction prohibited by Section 406(a) of ERISA, 29 U.S.C. 1106(a).

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INTEREST OF THE UNITED STATES

This case arises out of a suit filed by petitioners, as trustees of an employee benefit plan, to obtain restitution from respondent Salomon Brothers under Section 502(a)(3) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1132(a)(3), to redress a violation of ERISA's prohibition against certain transactions between a benefit plan and a party in interest with respect to the plan. See ERISA § 406(a), 29 U.S.C. 1106(a). The question presented is whether a party in interest who is not a fiduciary of the plan but who engages in a prohibited transaction with the plan is subject to suit under Section 502(a)(3) for restitution of the gains it realized as a result of the transaction.

Section 502(a)(3) authorizes civil actions to be brought by plan participants, beneficiaries, and fiduciaries to obtain "appropriate equitable relief" to redress violations of the Act. The Secretary of Labor is authorized to bring the same types of suits under Section 502(a)(5) of ERISA, 29 U.S.C.

1132(a)(5), and the Secretary has invoked that authority to sue parties in interest that violate ERISA's prohibited-transaction rules. See, *e.g.*, *Herman* v. *South Carolina Nat'l Bank*, 140 F.3d 1413, 1421 (11th Cir. 1998), cert. denied, 525 U.S. 1140 (1999); *Reich* v. *Compton*, 57 F.3d 270, 285 (3d Cir. 1995). This Court's interpretation of Section 502(a)(3) therefore may affect the scope of the Secretary's authority under Section 502(a)(5). In addition, the Secretary is charged with the administration and enforcement of Title I of ERISA, 29 U.S.C. 1101 *et seq.*, including the assessment of civil penalties against parties in interest that engage in prohibited transactions with a plan and obtaining correction of such transactions. See 29 U.S.C. 1132(i) and (*l*), 26 U.S.C. 4975(h). Because of the "enormity of the task" of enforcing the guarantees of ERISA, private civil actions under Section 502(a)(3) are a necessary complement to actions by the Secretary. Cf. *Trafficante* v. *Metropolitan Life Ins. Co.*, 409 U.S. 205, 211 (1972). The United States therefore has a substantial interest in the sound interpretation of Section 502(a)(3) of ERISA.

STATEMENT

1. a. The Employee Retirement Income Security Act of 1974, 29 U.S.C. 1001 *et seq.*, is a complex statutory scheme crafted to establish safeguards for the operation and administration of employee benefit plans and to ensure their financial soundness. 29 U.S.C. 1001(a). Congress intended to protect the interests of plan participants and beneficiaries by, *inter alia*, "providing for appropriate remedies, sanctions, and ready access to the Federal courts." 29 U.S.C. 1001(b).

The civil enforcement provisions of ERISA are set forth in Section 502, 29 U.S.C. 1132. Subsection (a) of Section 502, entitled "Persons empowered to bring a civil action," identifies nine types of causes of action that may be brought by various specified persons. The civil action in this case was

brought under Section 502(a)(3), which provides that an action may be brought—

> by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of [Title I of ERISA] or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of [Title I of ERISA] or the terms of the plan.

29 U.S.C. 1132(a)(3).

Title I of ERISA, 29 U.S.C. 1001-1169, relates to the protection of employee benefit rights. Title I includes Section 406 of ERISA, 29 U.S.C. 1106, entitled "Prohibited transactions." Subsection (a) of Section 406, entitled "Transactions between plan and party in interest," states that, except as provided in Section 408, 29 U.S.C. 1108—

> (1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—
>
> (A) sale or exchange, or leasing, of any property between the plan and a party in interest;
>
> (B) lending of money or other extension of credit between the plan and a party in interest;
>
> (C) furnishing of goods, services, or facilities between the plan and a party in interest;
>
> (D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; or
>
> (E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 1107(a).

29 U.S.C. 1106. Section 408 in turn sets forth various statutory exemptions from the prohibited-transaction rules in Section 406 and authorizes the Secretary to grant additional administrative exemptions, after affording public notice and an opportunity to comment. See 29 C.F.R. 2570.30-2570.52 (procedures for considering exemption applications).

b. ERISA defines a "fiduciary" as a person (1) who exercises discretionary authority or control respecting management of the plan or management or disposition of plan assets; (2) who renders, or has the authority or responsibility to render, investment advice for compensation regarding money or property of the plan; or (3) who has discretionary authority or responsibility in the administration of the plan. 29 U.S.C. 1002(21)(A). The term "party in interest" includes, *inter alia*, any fiduciary, counsel, or employee of a plan; a person providing services to the plan; an employer or employee organization any of whose employees or members are covered by the plan; a corporation or other entity that is owned by such a person; an employee, officer, or director of, or owner of a specified financial interest in, such a person; and a partner or joint venturer of such a person. 29 U.S.C. 1002(14).

2. Petitioner Ameritech Corporation sponsors and administers two pension plans whose assets are held in trust by Ameritech Pension Trust (APT). Petitioner Harris Trust and Savings Bank is a trustee of APT. National Investment Services of America (NISA) was an investment manager for APT during the relevant time period. The two pension plans qualify as employee benefit plans under ERISA. Both petitioners and NISA, by virtue of their relationships with APT, were at all relevant times fiduciaries of the plans within the meaning of ERISA. See 29 U.S.C. 1002(21)(A); Pet. App. 16a-17a.[1]

[1] This case comes to the Court based on rulings by the district court on cross-motions for summary judgment. In ruling on those motions, the district court viewed the evidence in the non-moving party's favor and did not make findings of fact. Pet. App. 56a. Our statement of facts is based on the lower courts' recitations. Respondents have reserved the right to dispute certain facts should the case go to trial. *Id.* at 6a.

Respondents, Salomon Brothers, Inc., and Salomon Brothers Realty Corp. (collectively "Salomon"), provided securities-brokerage and other services to APT during the relevant time period. Pet. App. 2a, 17a. Accordingly, Salomon was a party in interest with respect to the plans within the meaning of ERISA. See 29 U.S.C. 1002(14)(B).

In 1987, Salomon offered to sell to APT its interest in a written fee agreement that granted Salomon various rights, including participation in the net cash flow, sale or refinancing proceeds, and property appreciation associated with certain hotel properties. Pet. App. 17a-18a. On October 28, 1987, APT, at the direction of NISA, purchased 95% of the fee agreement. APT, through NISA, purchased 100% of a second fee agreement from Salomon in 1988, and 95% of two other fee agreements in 1989. APT paid a total of approximately $20,915,000 for the four fee agreements. *Id.* at 2a, 17a-19a. Petitioners allege that Salomon failed to disclose information about the properties that would have alerted petitioners to the precarious condition of the investments, and that, contrary to Salomon's representations, the fee agreements were virtually worthless when they were acquired by APT. *Id.* at 19a.

The issuers of the fee agreements subsequently went into bankruptcy. Pet. App. 19a. Petitioners contend that, as a result, APT lost $19,889,602, while Salomon realized a $20,915,000 profit on the transactions. Pet. 8.

3. Petitioners brought the instant suit against Salomon alleging violations of various state and federal laws, including several provisions of ERISA. Pet. App. 14a. The parties filed motions and cross-motions for summary judgment with

respect to various portions of the second amended complaint (complaint) and certain counterclaims. *Id.* at 14a-15a.

On June 13, 1996, the district court entered an order granting Salomon summary judgment on Count I of the complaint, which alleged breach of fiduciary duty, based on the court's determination that Salomon was not a fiduciary of the plan within the meaning of ERISA. Pet. App. 20a-30a. The court then turned to the question whether, even though Salomon was not a fiduciary, it was nonetheless subject to suit under Section 502(a)(3) as a nonfiduciary party in interest. Specifically, the court considered whether petitioners have a cause of action against Salomon for restitution under Section 502(a)(3) based on either Salomon's participation in a transaction prohibited by Section 406 of ERISA, 29 U.S.C. 1106 (Count II), or Salomon's knowing participation in the breach of fiduciary duty by NISA that occurred when NISA caused the transaction prohibited by Section 406 (Count III). The district court ruled in petitioners' favor on Count II (Pet. App. 30a-51a) and in respondents' favor on Count III (*id.* at 51a-52a).

With regard to Count III, the court relied on controlling circuit precedent, *Reich* v. *Continental Casualty Co.*, 33 F.3d 754 (7th Cir. 1994), cert. denied, 513 U.S. 1152 (1995). *Continental Casualty* in turn followed dicta in this Court's opinion in *Mertens* v. *Hewitt Associates*, 508 U.S. 248 (1993), where the majority found it "far from clear" that Section 502(a)(3) of ERISA generally provides a cause of action against a nonfiduciary that knowingly participates in a fiduciary's breach of its duties to the plan, because no provision of ERISA explicitly imposes a duty on nonfiduciaries to refrain from such participation. See 508 U.S. at 253-255 & n.5. The district court in this case therefore concluded that "ERISA does not provide a cause of action against nonfiduciaries for knowing participation in another person's fiduciary breaches." Pet. App. 51a.

The district court explained that its holding that petitioners do not have a cause of action under Count III did not require a similar conclusion with respect to Count II. The court reasoned that "nonfiduciary parties in interest may be held liable under § 1132 for their own involvement in a prohibited transaction because § 1106 can be read to affirmatively impose an obligation on parties in interest to avoid such transactions. Their status as a nonfiduciary party in interest, however, does not subject such persons to derivative liability for another's violation of ERISA. Thus, to the extent that Salomon participated in a prohibited transaction, it may be found directly liable under count II." Pet. App. 51a-52a. The court noted that this Court in *Mertens* "specifically contrasted the absence of any provision giving rise to a nonfiduciary's duty to avoid 'knowing participation,' with other provisions which, it recognized, can be read to impose an obligation on nonfiduciary parties in interest to avoid participation in § 1106(a) transactions." *Id.* at 33a (citing *Mertens*, 508 U.S. at 254 & n.4). The court also pointed out that the legislative history of ERISA "reflects a congressional intent to obligate nonfiduciary parties in interest to abstain from participation in § 1106(a) transactions." *Id.* at 34a.

Against this background, the district court held that Section 502(a)(3) of ERISA affirmatively authorizes a private civil action to obtain appropriate equitable relief, including restitution, from a nonfiduciary party in interest that violates Section 1106(a). Pet. App. 35a-41a. The court emphasized that the fact "[t]hat § 1132(a)(3) does not identify specific categories of potential defendants makes it clear that it was intended to authorize suit against any entity that violates ERISA," which a nonfiduciary party in interest does by engaging in a prohibited transaction. *Id.* at 36a. The court also pointed out that the courts of appeals that had addressed the issue had "uniformly found that ERISA's civil

enforcement provision, 29 U.S.C. § 1132, provides the requisite authority" for a suit against a nonfiduciary party in interest. *Id.* at 35a-36a (citing *Reich* v. *Stangl*, 73 F.3d 1027, 1032 (10th Cir.), cert. denied, 519 U.S. 807 (1996); *Landwehr* v. *Dupree*, 72 F.3d 726, 734 (9th Cir. 1995); *Reich* v. *Compton*, 57 F.3d 270, 285 (3d Cir. 1995); *Reich* v. *Rowe*, 20 F.3d 25, 31 n.7 (1st Cir. 1994)).[2]

4. The district court certified its order regarding Count II for interlocutory appeal under 28 U.S.C. 1292(b), Pet. App. 62a-65a, and the court of appeals reversed. *Id.* at 1a-13a. The court of appeals acknowledged that Section 502(a)(3) of ERISA "allows plan fiduciaries like [petitioners] to seek 'other appropriate equitable relief' for any act which violates ERISA." Pet. App. 7a. The court ruled, however, that the prohibited-transaction rules in ERISA Section 406 regulate only the conduct of fiduciaries and do not regulate the conduct of nonfiduciary parties in interest or impose any explicit duty on them. In reaching that conclusion, the court relied on the placement of Section 406 in a part of ERISA entitled "Fiduciary Responsibility," and on the wording of Section 406, which states that "a fiduciary * * * shall not

[2] The district court rejected Salomon's argument that, under Seventh Circuit precedent, restitution is not available as an equitable remedy in this case. Pet. App. 41a (emphasizing that limiting restitution to an equitable remedy in cases involving participation in a fiduciary breach "would be inappropriate in light of traditional trust law which provides rules permitting equitable actions to regain improperly transferred trust property for reasons other than the recipient's knowing participation in the trustee's breach of its fiduciary duties"). The court also rejected Salomon's argument regarding failure of proof (*id.* at 41a-42a), denied petitioners' motion for summary judgment insofar as it sought to establish the inapplicability of a prohibited-transaction exemption for security transactions because it found genuine issues of material fact on that question (*id.* at 44a-51a), concluded that a ruling on Salomon's statute-of-limitations defense would be premature (*id.* at 52a-53a), and granted summary judgment to petitioners on Salomon's counterclaims for contribution (*id.* at 53a-54a).

cause" the plan to engage in a prohibited transaction. *Ibid.* The court also reasoned that the fact that Section 406 "mentions 'parties in interest' when it describes the transactions that fiduciaries must avoid does not mean that parties in interest are liable when a fiduciary does engage in a prohibited transaction." *Id.* at 8a; see also *id.* at 7a. The court therefore found no material distinction between this case and *Continental Casualty*, in which the Seventh Circuit held "that where ERISA does not expressly impose a duty, there can be no cause of action." *Id.* at 8a.

The court of appeals rejected petitioners' attempt to distinguish this case from *Continental Casualty* on the ground that Section 502(i) of ERISA, 29 U.S.C. 1132(i), authorizes the Secretary of Labor to impose civil penalties on a party in interest that engaged in a transaction prohibited by Section 406. In the court's view, the provision for civil penalties in this situation "only makes the absence of a specific provision imposing civil liability on parties in interest all the more striking." Pet. App. 9a. The court also found it significant that when Congress enacted the final bill into law, it dropped a provision in the Senate bill that would have explicitly imposed liability on parties in interest that participate in violations of the Act. *Id.* at 12a.

SUMMARY OF ARGUMENT

A. Section 502(a)(3) of ERISA authorizes a civil action to be brought by a plan participant, beneficiary, or fiduciary "to enjoin any act or practice which violates any provision" of Title I of ERISA and "to obtain other appropriate equitable relief * * * to redress such violations." 29 U.S.C. 1132(a)(3). The text of Section 502(a)(3) is not limited to suits against fiduciaries; it also readily embraces suits against nonfiduciary parties in interest that engage in transactions prohibited by Section 406(a) in Title I of ERISA, 29 U.S.C. 1106(a). Such a transaction plainly constitutes a "vio-

lation" of ERISA and can, therefore, be redressed through a Section 502(a)(3) civil action.

B. The overall structure of ERISA's prohibited-transaction provisions confirm that conclusion. Section 3003 of ERISA, 29 U.S.C. 1203, which requires coordination of enforcement efforts by the Secretary of Labor and the Secretary of the Treasury with respect to prohibited transactions, expressly states that a party in interest that engages in a prohibited transaction is "violating" Section 406. The civil penalty provision in Section 502(i) of ERISA, 29 U.S.C. 1132(i), and its companion tax provision, 26 U.S.C. 4975, expressly contemplate "correction" of a prohibited transaction by the party in interest, and thereby establish that a party in interest is not entitled to retain plan assets or profits it improperly acquired in such a transaction. And another civil penalty provision, in Section 502(*l*) of ERISA, 29 U.S.C. 1132(*l*), establishes that Section 502(a)(5), which authorizes the Secretary to bring civil actions on essentially the same terms as private parties under Section 502(a)(3), enables the Secretary to bring suit for equitable relief against a nonfiduciary party in interest that engaged in a prohibited transaction with the plan. Because the relevant statutory language in the two provisions is identical, Section 502(a)(3) should be similarly interpreted.

The civil penalty provisions reflect ERISA's preference that a prohibited transaction be remedied by restoration of the plan's financial resources rather than through a civil penalty or tax—a preference that furthers the central purpose of ERISA to safeguard and ensure the financial soundness of employee benefit plans. 29 U.S.C. 1001(a). An interpretation of Section 502(a)(3) (or Section 502(a)(5)) that precluded suits for restitution from nonfiduciary parties in interest would contradict that statutory preference.

C. The court of appeals' holding that such suits may not be brought under Section 502(a)(3) conflicts with established

principles of trust law and equity, to which this Court looks when interpreting ERISA. Under those principles, appropriate equitable relief includes restitution of trust assets, generally through imposition of a constructive trust, from third-parties to whom trust property was transferred in breach of the trust. The ability to obtain restitution from a transferee of trust property is not based on the nonfiduciary's own breach of a legal duty, but rather on a theory of unjust enrichment.

D. The court of appeals' interpretation of Section 502(a)(3) was based, in part, on its erroneous belief that there is no material distinction between the issue in this case and the issue discussed by this Court in dicta in *Mertens* v. *Hewitt Associates*, 508 U.S. 248, 254 (1993), regarding whether Section 502(a)(3) provides for a cause of action against a nonfiduciary for knowing participation in a fiduciary breach. Even if the *Mertens* majority's doubts on the latter point were well founded, there would be no rationale for extending that conclusion to bar suits against parties in interest, and indeed later in the opinion the Court specifically distinguished the situation of parties in interest that violate Section 406's prohibited-transaction rules. *Id.* at 262.

E. The legislative history of ERISA, both as originally enacted and as amended in 1989 to add the civil penalty provision in Section 502(*l*), also supports an interpretation of Sections 502(a)(3) and (5) that authorizes civil actions for restitution against nonfiduciary parties in interest that engage in prohibited transactions with the plan.

ARGUMENT

SECTION 502(a)(3) OF ERISA PROVIDES A CAUSE OF ACTION FOR RESTITUTION AGAINST A NON-FIDUCIARY PARTY IN INTEREST THAT ENGAGED IN A TRANSACTION WITH THE PLAN THAT WAS PROHIBITED BY SECTION 406(a) OF ERISA

A. The Text Of Section 502(a)(3) And Section 406(a)

1. Section 502(a)(3) of ERISA states that a plan participant, beneficiary, or fiduciary may bring a civil action "to enjoin any act or practice which violates any provision" of Title I of the Act (the Title in which Section 406 is located), or "to obtain other appropriate equitable relief * * * to redress such violations." 29 U.S.C. 1132(a)(3). ERISA contains no language limiting that provision to suits against fiduciaries. Because Section 502(a)(3) does not specify or in any way limit the entities that may be sued, it authorizes suit against any entity from which appropriate equitable relief may be obtained to redress a violation of ERISA.[3]

A transaction that is prohibited by Section 406(a) of ERISA unquestionably constitutes a "violation" of ERISA. Section 406 flatly bars the specified types of transactions, subject to the statutory and administrative exemptions provided for in Section 408, 29 U.S.C. 1108. Congress entitled Section 406 "Prohibited transactions," and it entitled subsection (a) of that Section "Transactions between plan and

[3] Section 502(a)(3) also authorizes civil actions to enjoin any act or practice that violates the terms of a plan and to obtain other equitable relief to enforce any term of a plan. That provision also allows actions against defendants other than a fiduciary. See, *e.g.*, *Administrative Comm.* v. *Gauf*, 188 F.3d 767, 770-771 (7th Cir. 1999) (allowing Section 502(a)(3) claim against participant, under plan's subrogation provision, for reimbursement following participant's tort recovery); *Blue Cross & Blue Shield* v. *Sanders*, 138 F.3d 1347, 1353 (11th Cir. 1998) (same); *Southern Council of Indus. Workers* v. *Ford*, 83 F.3d 966, 969 (8th Cir. 1996) (same).

party in interest." That structure manifests an intent to render unlawful the specified transactions themselves, and not merely to impose a duty on fiduciaries. Although Section 406(a) expressly imposes on a fiduciary a duty not to cause the plan to engage in a prohibited transaction, "this in no sense lessens the fact that a transaction between a plan and a 'party in interest' remains a prohibited transaction under § 406"—a violation that can be redressed in a civil action under Section 502(a)(3) to obtain restitution to the plan or other appropriate equitable relief. *Herman* v. *South Carolina Nat'l Bank*, 140 F.3d 1413, 1421 (11th Cir. 1998), cert. denied, 525 U.S. 1140 (1999).

2. The court of appeals read Section 406(a) not to impose any duties on parties in interest, because Section 406(a) expressly imposes a duty on a fiduciary not to cause the plan to engage in a prohibited transaction with a party in interest, but does not address parties in interest in similar terms. Pet. App. 7a-8a. What the court of appeals failed to appreciate is that the imposition of an express duty on fiduciaries not to cause a plan to engage in prohibited transactions serves to make it clear that a fiduciary that breaches that duty is subject to suit not only for engaging in a prohibited transaction that violates the Act, but also for breach of fiduciary duty. A suit under Section 502(a)(2) for breach of fiduciary duty allows for recovery not only of equitable relief (which would be allowed as well in a suit under Section 502(a)(3) to obtain redress for a prohibited transaction), but also for recovery of legal damages. Section 502(a)(2) authorizes a suit by the Secretary (or by a plan participant, beneficiary, or fiduciary) for appropriate relief under Section 409 of the Act, which in turn provides that a fiduciary who "breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by [Title I of ERISA] shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such

plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate." 29 U.S.C. 1109(a). See *Lockheed Corp.* v. *Spink*, 517 U.S. 882, 888 (1996); *Mertens*, 508 U.S. at 252.

Moreover, to interpret Section 502(a)(3) based on what "duties" are or are not expressly imposed by Section 406(a) would ignore the plain language of Section 502(a)(3), which is couched in terms of suits to redress any act or practice that "violates" Title I of ERISA. A transaction prohibited by Section 406(a) plainly constitutes an "act or practice" that "violates" a provision of Title I of ERISA, and it therefore may properly be the subject of an action under Section 502(a)(3) to obtain "appropriate equitable relief" to "redress" that violation. Appropriate equitable relief in these circumstances includes relief not only against the fiduciary that caused the plan to engage in the prohibited transaction, but also against any other entity from which it would be appropriate to obtain equitable relief—certainly including a party in interest that itself engaged in the prohibited transaction and that was unjustly enriched by its improper receipt of plan assets. The term "redress" means "the setting right of what is wrong." *The Random House Dictionary of the English Language* 1617 (2d ed. 1987); see also *Webster's Third New International Dictionary* 1904 (1986). Accordingly, equitable relief appropriate to redress a violation of Section 406(a) "includes restitution of ill-gotten plan assets or profits." *Mertens*, 508 U.S. at 248.[4]

[4] The court of appeals erred in concluding that suits for violations of Section 406 should be limited to suits against fiduciaries because Section 406 appears in Part 4 of Title I of ERISA, which is captioned "Fiduciary Responsibility." Despite that caption, Part 4, which encompasses 29 U.S.C. 1101-1114, contains provisions that unquestionably impose duties on persons other than fiduciaries. For example, Section 411, 29 U.S.C. 1111, forbids individuals convicted of certain enumerated felonies from serving not only as plan fiduciaries but also as service providers. And Section 412, 29 U.S.C. 1112, requires the bonding of both plan fiduciaries and any other person who handles plan property. That Section also makes it unlawful for any person to purchase such bonds from a company in which the plan or any party in interest has a significant or controlling interest. 29 U.S.C. 1112(a) and (c).

B. The Overall Structure Of ERISA's Prohibited-Transaction Provisions

Several other provisions of ERISA relating to prohibited transactions confirm that Congress viewed a nonfiduciary party in interest that engaged in a transaction prohibited by Section 406(a) as having committed a violation of ERISA and as obligated to make the plan whole.

1. Congress made this conclusion explicit in Section 3003 of ERISA, 29 U.S.C. 1203, which addresses the procedures that the Secretary of Labor and the Secretary of the Treasury must follow in order to ensure coordination of their duties with respect to prohibited transactions. Specifically, Section 3003(c) states:

> Whenever the Secretary of Labor obtains information indicating that a party-in-interest or disqualified person is violating section 1106 of this title [ERISA § 406], he shall transmit such information to the Secretary of the Treasury.

29 U.S.C. 1203(c). Section 502(a)(3), which authorizes civil actions to redress "any" act or practice that constitutes a "violation" of "any" provision of Title I of the Act, must be read in pari materia with that provision, which unequivocally treats a party in interest that engages in a transaction prohibited by Section 406 as "violating" that provision.

2. ERISA's civil penalty provisions reinforce the conclusion that a nonfiduciary party in interest is not a mere passive participant in a transaction prohibited by Section

406(a) that might therefore be permitted by ERISA to retain any profits it realizes from such a transaction, but rather is itself in violation of ERISA and therefore not entitled to retain plan assets or profits that unjustly enrich it.

a. Section 502(i) of ERISA, 29 U.S.C. 1132(i), provides that "[i]n the case of a transaction prohibited by [Section 406] by a party in interest with respect to a plan," the Secretary of Labor may assess a civil penalty against the party in interest. Under a parallel provision in Title II of ERISA, which is codified in the Internal Revenue Code (IRC), the Secretary of the Treasury may impose a tax on a prohibited transaction, to be paid by the "disqualified person" (defined in a manner substantially similar to "party in interest" under Title I) that engages in the prohibited transaction. 26 U.S.C. 4975(a); see generally *Commissioner* v. *Keystone Consol. Indus., Inc.*, 508 U.S. 152 (1993).[5]

[5] Whether it is the Secretary of Labor or the Secretary of the Treasury who has jurisdiction to assess a penalty or tax depends on whether the plan is a tax-qualified plan, and thus covered by 26 U.S.C. 4975(e)(1) (1994 & Supp. III 1997). See 29 U.S.C. 1132(i) (Subsection (i) does "not apply to a transaction with respect to a plan described in section 4975(e)(1) of title 26"). In general, pension plans are covered by 26 U.S.C. 4975, while welfare benefit plans are covered by 29 U.S.C. 1132(i). The tax provision defines "prohibited transaction" in a manner that is substantially similar to that in which Section 406 defines that term under Title I of ERISA. See 26 U.S.C. 4975(c) (1994 & Supp. III 1997). The tax provision also defines "disqualified person" in a manner that is substantially similar to that in which Section 3(14) of ERISA, 29 U.S.C. 1002(14), defines "party in interest" for purposes of Title I. See 26 U.S.C. 4975(e)(2).

The court of appeals erred in treating this case as one in which the Secretary of Labor could impose a civil penalty on respondents under 29 U.S.C. 1132(i). See Pet. App. 8a-9a. Because this case apparently involves a tax-qualified plan within the meaning of Section 4975(e)(1), respondents would be subject to imposition of a tax by the Secretary of the Treasury, but only after referral to the Secretary of Labor to provide her a reasonable opportunity to obtain a correction by respondents of the prohibited transaction. See 29 U.S.C. 4975(h).

The amount of the civil penalty or tax depends upon whether the transaction is "corrected" in a timely manner. Correcting a prohibited transaction means "undoing the transaction to the extent possible, but in any case placing the plan in a financial position not worse than that in which it would be if the disqualified person were acting under the highest fiduciary standards." 26 U.S.C. 4975(f)(5); accord 29 U.S.C. 1132(i) (providing for correction of a prohibited transaction by the party in interest "in such manner as the Secretary [of Labor] shall prescribe which shall be consistent with section 4975(f)(5) of title 26").[6] If the prohibited transaction is not corrected within 90 days after notice from the Secretary of Labor (or such longer time as the Secretary may permit), the penalty assessed against the party in interest may equal 100% of the amount involved in the transaction. 29 U.S.C. 1132(i); see also 26 U.S.C. 4975(b) (providing for assessment of 100% tax if the transaction is not corrected within the taxable period); *Keystone Consol. Indus.*, 508 U.S. at 155 n.1.[7] Thus, it is clear that Congress intended that parties in interest that engage in prohibited transactions would "correct" those transactions and thus would not be

[6] The procedures for assessment of civil sanctions by the Secretary of Labor under Section 502(i) are set forth at 29 C.F.R. 2570.1 to 2570.12. Those procedures afford the party in interest an opportunity for a hearing, an administrative appeal, and judicial review pursuant to the Administrative Procedure Act, 5 U.S.C. 704. See 29 C.F.R. 2570.1, 2570.8(b), 2570.10, 2570.12(b). The 90-day correction period under Section 502(i) ends 90 days after the final agency order with respect to the transaction or, if the party in interest seeks judicial review of a final agency order, 90 days after the entry of a final order in the judicial action. See 29 C.F.R. 2560.502i-1(d).

[7] If the prohibited transaction is corrected in a timely manner, the tax shall not exceed 15% of the amount of the transaction for each year (or part thereof) in the taxable period, 26 U.S.C. 4975(a) (Supp. III 1997), and the civil penalty shall not exceed 5% of the amount of the transaction for each year (or part thereof) during which the prohibited transaction continues, 29 U.S.C. 1132(i).

entitled to remain unjustly enriched as a result of such transactions. Disgorgement or restitution by a party in interest therefore is "appropriate equitable relief" under Section 502(a)(3) to "redress" the prohibited transaction.

b. Another civil penalty provision, in Section 502(*l*) of ERISA, 29 U.S.C. 1132(*l*), strongly reinforces that conclusion. Section 502(*l*) makes clear that Section 502(a)(5), 29 U.S.C. 1132(a)(5), which authorizes the Secretary of Labor to bring a civil action on the same terms as a plan participant, beneficiary, or fiduciary may bring an action under Section 502(a)(3) to redress a violation of the Act, enables the Secretary to bring suit against a nonfiduciary party in interest to obtain restitution to the plan to remedy a prohibited transaction.

Section 502(*l*), which was added to ERISA in 1989 (Pub. L. No. 103-239, § 2101(a), 101 Stat. 2123), provides for a civil penalty that applies to a broader category of violations than does Section 502(i). It authorizes the Secretary of Labor to assess a civil penalty in the case of "(A) any breach of fiduciary responsibility under (or other violation of) part 4" of Title I of ERISA "by a fiduciary," or "(B) any knowing participation in such a breach or violation by any other person." 29 U.S.C. 1132(*l*)(1)(A) and (B). Violations of Part 4 of Title I include violations of the prohibited-transaction rules in Section 406(a). The civil penalty is equal to 20% of the "applicable recovery amount." 29 U.S.C. 1132(*l*)(1). The latter term is defined to mean "any amount which is recovered from a fiduciary *or other person* with respect to a breach or violation described in paragraph (1)," either "(A) pursuant to any settlement agreement with the Secretary," or "(B) ordered by a court to be paid by such fiduciary *or other person* to a plan or its participants and beneficiaries *in a judicial proceeding instituted by the Secretary under subsection* (a)(2) or *(a)(5)* of this section." 29 U.S.C. 1132(*l*)(2) (emphasis added). Subsection (a)(2) of Section 502 authorizes the Secretary (or a plan participant, beneficiary, or fiduciary) to bring a civil action against a fiduciary for appropriate relief under Section 409 of the Act, 29 U.S.C. 1109, to redress a fiduciary breach, and subsection (a)(5) authorizes the Secretary to bring a civil action for appropriate equitable relief to redress a violation of Title I. Because subsection (a)(2) affords the Secretary a fully adequate means of obtaining redress against a fiduciary, the reference to subsection (a)(5) plainly contemplates that the Secretary will invoke that subsection to obtain redress against the "other person[s]" mentioned in Section 502(*l*)—in this case, parties in interest that are not fiduciaries.

Indeed, there can be no doubt that, when it enacted Section 502(*l*) in 1989, Congress intended that the persons "other" than fiduciaries from whom the Secretary may obtain appropriate equitable relief under Section 502(a)(5) include nonfiduciary parties in interest who violate the prohibited-transaction rules in Section 406. That is so because the final sentence of Section 502(*l*) specifies that "[t]he penalty imposed on a fiduciary or other person under this subsection with respect to any transaction shall be reduced by the amount of any penalty or tax imposed on such fiduciary or other person with respect to such transaction under subsection (i) of this section and section 4975 of title 26." 29 U.S.C. 1132(*l*)(4). As explained above, the penalty imposed under subsection (i) of Section 502 and the tax assessed under Section 4975 apply to nonfiduciary parties in interest that engage in prohibited transactions. Thus, nonfiduciary parties in interest are necessarily included among the "other person[s]" referred to in the final sentence of Section 502(*l*).[8] The reduction of the Section 502(*l*) penalty

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[8] In *Mertens*, the Court suggested that the reference in Section 502(*l*) to "any other person" who knowingly participates in a fiduciary breach might be to a co-fiduciary, since Section 405(a) of the Act, 29 U.S.C. 1105(a), renders a co-fiduciary liable for breaches of fiduciary duty by

imposed on "any other person" who engaged in a prohibited transaction—a penalty that is based on a percentage of the amount recovered in a civil action by the Secretary under Section 502(a)(5)—makes sense only if the "other person" who engaged in the prohibited transaction (*i.e.*, the party in interest) is subject to suit by the Secretary under Section 502(a)(5) to obtain appropriate equitable relief to redress the prohibited transaction.

Because a participant, beneficiary, or fiduciary may bring the same type of actions under Section 502(a)(3) that the Secretary may bring under Section 502(a)(5), see *Varity Corp.* v. *Howe*, 516 U.S. 489, 510 (1996),[9] it follows that Section 502(a)(3) likewise authorizes a civil action against a nonfiduciary party in interest to obtain appropriate equitable relief to redress a prohibited transaction. See *Mertens*, 508 U.S. at 260.

c. ERISA's civil penalty provisions applicable to prohibited transactions make it clear that obtaining restitution to a plan from a nonfiduciary party in interest to redress a prohibited transaction is the primary focus of those statutory

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another fiduciary in certain circumstances. See 508 U.S. at 260-261. But co-fiduciaries are fiduciaries. The only reading of the references in Section 502(*l*) to "fiduciary or other person" that gives meaning to all of its words is one in which "other person" means a person who is *not* a fiduciary—including a person, such as respondent Salomon, who is a nonfiduciary party in interest. The term "person" is specifically defined in ERISA to mean "an individual, partnership, joint venture, corporation, mutual company, joint-stock company, trust, estate, unincorporated organization, association, or employee organization." 29 U.S.C. 1002(9). That definition is not limited to "fiduciary," a term that is separately defined in 29 U.S.C. 1002(21). The discussion of "other person" in *Mertens* did not advert to the separate definition of "person."

[9] The only difference between Subsections (a)(3) and (a)(5) is that the former includes actions to redress violations of, or to enforce, terms of a plan as well as the Act; under the latter, the Secretary is limited to bringing actions to redress violations of, or to enforce, the Act itself.

enforcement mechanisms, and that such redress takes priority over assessing against the party in interest a civil penalty or tax to be paid into the United States Treasury. First, before sending a notice of tax deficiency, the Secretary of the Treasury must notify the Secretary of Labor and provide her a reasonable opportunity to obtain a correction of the transaction or comment on the proposed tax assessment. 26 U.S.C. 4975(h); 29 U.S.C. 1203(a). Moreover, as noted above (at p. 17), the civil penalty or tax imposed under Section 502(i) of ERISA or 26 U.S.C. 4795 increases to 100% of the amount of the transaction *only* if the party in interest does not correct the transaction—*i.e.*, undo the transaction to the extent possible or otherwise restore the plan's financial position—within a specified period. Finally, the civil penalty under Section 502(*l*) may be waived or reduced by the Secretary if the fiduciary or other person otherwise "will not be able to restore all losses to the plan * * * without severe financial hardship." 29 U.S.C. 1132(*l*)(3)(B); see also 29 U.S.C. 1203(a) (authorizing Secretary of Treasury to waive tax imposed by Section 4975 in appropriate cases).

That preference for redress to the plan over imposition of civil penalties or fines is consistent with the central purpose of ERISA to safeguard and ensure the financial soundness of employee benefit plans. 29 U.S.C. 1001(a). By contrast, to limit civil actions under Sections 502(a)(3) and 502(a)(5) in a manner that precludes suits for restitution of plan assets from nonfiduciary parties in interest would contradict that statutory preference. It also would contradict ERISA's stated intent to provide for "ready access to the Federal courts." 29 U.S.C. 1001(b). See also *Varity Corp.*, 516 U.S. at 512 (characterizing Section 502(a)(3) as a "safety net, offering appropriate equitable relief for injuries caused by violations that § 502 does not elsewhere adequately remedy").

C. Background Principles Of Trust Law And Equity And The Purposes Of ERISA

1. The court of appeals' holding that an action will not lie against a nonfiduciary party in interest under Section 502(a)(3) for restitution or disgorgement of assets and profits obtained in a prohibited transaction is inconsistent with established common law trust principles to which this Court looks "to develop a 'federal common law of rights and obligations under ERISA-regulated plans.'" *Firestone Tire & Rubber Co.* v. *Bruch*, 489 U.S. 101, 110 (1989) (quoting *Pilot Life Ins. Co.* v. *Dedeaux*, 481 U.S. 41, 56 (1987)). Congress defined the cause of action under Section 502(a)(3) in traditional trust terms—a civil action for "appropriate equitable relief." 29 U.S.C. 1132(a)(3). Congress's choice of that terminology is naturally understood as referring to background principles of trust law and equity for further definition of the cause of action it created. See also S. Rep. No. 383, 93d Cong., 1st Sess. 105 (1973), *reprinted in* 1 *Legislative History of the Employee Retirement Income Security Act of 1974*, at 1173 (1976) (*Leg. Hist.*) (stating that appropriate relief would include the equitable remedy of a constructive trust). Cf. *Mertens*, 508 U.S. at 260 ("the 'equitable relief' awardable under § 502(a)(5) includes restitution of ill-gotten plan assets or profits").

Traditionally, appropriate equitable relief included restitution of trust assets, generally through imposition of a constructive trust, from third-parties to whom trust property was transferred in breach of the trust. See generally Restatement (Second) of Trusts §§ 288, 289, 290, at 55-57 (1959); George Bogert & George Bogert, *Trusts and Trustees* § 868, at 109-112 (1995); William Fratcher, *Scott on Trusts* § 291.1, at 77-78 (1989).[10] The ability to obtain

[10] Restitution is a core concept in equity, employed principally through the remedy of a constructive trust. Elaine Shoben & William Tabb, *Cases and Problems on Remedies* 711 (1989); Restatement of Restitution § 160, at 140, Introductory Note 9 (1937); John Dawson, *Unjust Enrichment* 26 (1951); *Stauffer* v. *Stauffer*, 351 A.2d 236, 241 (Pa. 1976) (constructive trust "is an equitable remedy designed to prevent unjust enrichment").

restitution from a transferee of trust property was not based on the nonfiduciary's *own* breach of a legal duty, contrary to the suggestion in *Mertens*, 508 U.S. at 255 n.5. A constructive trust to obtain restitution from a nonfiduciary was based on principles of unjust enrichment, not independent wrongdoing, Dan B. Dobbs, *Law of Remedies* § 4.3(2), at 397 (2d ed. 1993), and the cause of action was typically viewed as arising from the duties imposed by equity on the breaching trustee. See *Strauss* v. *United States Fidelity & Guar. Co.*, 63 F.2d 174, 178 (4th Cir.), cert. denied, 289 U.S. 747 (1933); *Safe Deposit & Trust Co.* v. *Cahn*, 62 A. 819, 822 (Md. 1906); see also, *e.g.*, George Bogert & George Bogert, *supra*, § 889, at 257. Section 502(a)(3) therefore should be construed, consistently with those principles of trust law and equity, to allow a civil action for restitution or disgorgement against a party in interest such as Salomon who is unjustly enriched by its unlawful receipt of plan assets or its improper profiting from a prohibited transaction with a plan.

2. The remedial purposes of Section 406—to bar categorically transactions that experience had shown were likely to injure or be unfair to the plan, *Keystone Consol. Indus.*, 508 U.S. at 160—would be substantially weakened if a cause of action did not lie against a party in interest in these circumstances. "Such an interpretation of [S]ection 502(a)(5) [and therefore of Section 502(a)(3)] * * * effectively create[s] a zone of immunity, protecting the illegitimate gains of parties in interest who have completed prohibited transactions that the Secretary could have enjoined while they were occurring." *Stangl*, 73 F.3d at 1031. For example, where a fiduciary accepts money from a party in interest in

exchange for a recommendation that the plan invest millions of dollars in a real estate development, the developer that offered the illegal incentive and that consequently received the millions of dollars in plan assets would be permitted to keep those plan assets under the court of appeals' interpretation (albeit subject to an excise tax or civil penalty that goes to the federal treasury rather than the plan). Nonfiduciary parties in interest would be allowed to remain unjustly enriched, and the plan would be unable to obtain full relief if the fiduciary that caused the transactions is judgment-proof or has limited resources. Furthermore, in cases where unique assets, such as real estate, have been transferred to a party in interest, a remedy against the fiduciary that caused the transfer would necessarily be inadequate.

D. This Court's Decision In *Mertens*

The majority in *Mertens* expressed doubt that ERISA provides a cause of action against a nonfiduciary for knowing participation in a fiduciary breach. 508 U.S. at 253-254. The dissenting opinion had no such doubts, however, see *id.* at 265 n.1, and the Court did not resolve the question, *id.* at 254-255. We continue to believe that Sections 502(a)(3) and 502(a)(5) do provide such a cause of action.[11] That question, however, is not squarely presented in this case and, as in *Mertens*, the Court should not resolve it here.

Whether or not the *Mertens* majority's doubts on that issue were well founded, the majority did not suggest that it had doubts about whether Section 502(a)(3) authorizes an action against nonfiduciary parties in interest who violate the prohibited-transaction rules in Section 406. To the contrary, at a later point in the opinion, the Court stated that

[11] We sought certiorari on that issue after *Mertens* in *Reich* v. *Continental Casualty Co.*, No. 94-1094, but the Court denied the petition. 513 U.S. 1152 (1995).

persons who provide services to a plan "must disgorge assets and profits obtained through participation as parties-in-interest in transactions prohibited by § 406, and pay related civil penalties, see § 502(i), 29 U.S.C. § 1132(i), or excise taxes, see 26 U.S.C. § 4975; and (assuming nonfiduciaries can be sued under § 502(a)(3)) may be enjoined from participating in a fiduciary's breaches, compelled to make restitution, and subject to other equitable decrees." *Mertens*, 508 U.S. at 262. The Court thus distinguished between the requirement that service providers disgorge assets and profits obtained through participation as parties in interest in prohibited transactions, which the Court did not question, and potential liability for participation in a fiduciary's breach of its fiduciary duty, which the Court merely assumed for purposes of its decision.

Furthermore, the Court made those observations in the course of discussing how ERISA "allocates liability for plan-related misdeeds in reasonable proportion to respective actors' power to control and prevent the misdeeds." 508 U.S. at 262. Even if the *Mertens* majority were correct in its suggestion that Sections 502(a)(3) and 502(a)(5) do not generally provide a cause of action against nonfiduciary third parties who participate in fiduciary breaches, there would be no justification for extending that conclusion to bar a suit against a party in interest that had full control over its role in the prohibited transaction with the plan. As shown by background principles of trust law and equity, as well as by the civil penalty and tax provisions of ERISA itself, a party in interest that receives plan assets through a prohibited transaction is properly subject to a civil action for restitution or other appropriate equitable relief to redress the transaction.[12]

[12] In *Lockheed Corp.*, 517 U.S. at 889 n.3, the Court noted that its discussion in *Mertens* of the liability of parties in interest to disgorge assets and profits obtained in violation of Section 406(a) was dicta. The

E. The Legislative History Of ERISA

The legislative history of ERISA supports an interpretation of Sections 502(a)(3) and 502(a)(5) that authorizes actions for restitution against nonfiduciary parties in interest who engage in prohibited transactions.

1. The Conference Report accompanying the final bill enacted as ERISA in 1974 specifically states that the prohibited-transaction provisions "prohibit[] plan fiduciaries and parties-in-interest from engaging in a number of specific transactions." H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 306 (1974), *reprinted in* 3 *Leg. Hist.* 4573. That clear statement confirms the common sense reading of the prohibited-transaction provision—that such transactions violate the Act and that both parties are prohibited from engaging in such transactions.

Moreover, the Conference Report indicates that the statutory language in Section 406(a) directed specifically at fiduciaries was not intended to render fiduciaries the only persons liable for engaging in a prohibited transaction, as the court of appeals believed. See Pet. App. 7a-8a. Rather, the wording of Section 406(a)—"[a] fiduciary * * * shall not cause the plan to engage in a transaction, if he knows or should know" that the transaction constitutes one of the

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Court also noted that its discussion in *Mertens* in any event suggested such liability only when a violation of Section 406(a) is established, which, under *Lockheed*, "requires a showing that a fiduciary caused the plan to engage in the transaction in question." *Ibid.* The Court went on to say that, therefore, the lower court in *Lockheed* "was not necessarily wrong in saying that 'a party in interest who benefitted from an *impermissible* transaction can be held liable under ERISA.'" *Ibid.* (emphasis added by this Court). This case has proceeded on the assumption that a fiduciary (NISA) caused the plan to engage in the prohibited transaction, which establishes a violation of Section 406. See *Lockheed*, 517 U.S. at 888-889. Salomon, as a nonfiduciary party in interest, benefitted from that impermissible transaction. Accordingly, it should be liable for restitution to the plan.

listed prohibited transactions—was intended to impose a knowledge requirement before a fiduciary could be held personally liable, including for damages. The Report explains that that language reflects one of the distinctions between the prohibited-transaction provisions and exemptions in Title I of ERISA and the corresponding provisions in the IRC: "Under the labor provisions, a fiduciary will be liable only if he knew or should have known that he engaged in a prohibited transaction. Such a knowledge requirement is not included in the tax provisions. This distinction conforms to the distinction in present law in the private foundation provisions (where a foundation's manager generally is subject to a tax on self-dealing if he acted with knowledge, but a disqualified person is subject to tax without proof of knowledge)." H.R. Conf. Rep. No. 1280, *supra*, at 306-307, *reprinted in* 3 *Leg. Hist.* 4573-4574. Thus, the Conference Report is consistent with parties in interest (and disqualified persons) being liable without such knowledge, but only for equitable relief (*e.g.*, an injunction or disgorgement) under Section 502(a)(3) and (5) and for a civil penalty under Section 502(i) or a tax under 26 U.S.C. 4975.[13]

The court of appeals focused not on the Conference Report, but on the fact that the version of the bill that passed the Senate included a provision that would have expressly

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[13] The Conference Report further explains, however, that, "[i]n general, it is expected that a transaction will not be a prohibited transaction (under either the labor or the tax provisions) if the transaction is an ordinary 'blind' purchase or sale of securities through an exchange where neither buyer nor seller (nor the agent of either) knows the identity of the other party involved. In this case, there is no reason to impose a sanction on a fiduciary (or party-in-interest) merely because, by chance, the other party turns out to be a party-in-interest (or plan)." H.R. Conf. Rep. No. 1280, *supra*, at 307, *reprinted in* 3 *Leg. Hist.* 4574. Again, the Report could not be clearer in its view that parties in interest are prohibited from engaging in particular transactions with a plan and can be sanctioned for their violation of that prohibition.

imposed personal liability, including for damages, on any party in interest who knowingly participated in a transaction prohibited by the Act. See Pet. App. 12a (quoting H.R. 2, 93d Cong., 2d Sess. § 511, at 538-574) (with amendments as passed by the Senate), *reprinted in* 3 *Leg. Hist.* at 3780. The court of appeals inferred from the omission of that provision in the final bill that Congress did not intend to subject nonfiduciary parties in interest to a civil action for restitution or other appropriate equitable relief. Pet. App. 12a. The court failed to recognize, however, that at the same time the Conference Committee declined to adopt the specific provision in the Senate bill subjecting a party in interest to liability, it broadened the general civil enforcement section, beyond the provision in the House bill that allowed suits to enjoin any act or practice that violates Title I (H.R. 2, 93d Cong., 2d Sess., § 503(e)(3), at 150, *reprinted in* 3 *Leg. Hist.* at 4047), to include as well the provision in Sections 502(a)(3) and 502(a)(5) for other "appropriate equitable relief" to "redress" such a violation. See H.R. Conf. Rep. No. 1280, *supra*, at 327, *reprinted in* 3 *Leg. Hist.* at 4594 (conferees expanded Section 502 to allow the Secretary to bring "an action for breach of a fiduciary duty or to enjoin any act or practice which violates * * * title I of the Act or to obtain any other appropriate relief to enforce any provision of that title"). In light of that broad language ultimately chosen by Congress, an interpretation of Section 502(a)(3) that allows actions against nonfiduciary parties in interest for restitution or other appropriate equitable relief is fully consistent with the legislative record. See *Stangl*, 73 F.3d at 1033-1034.

2. That conclusion is reinforced by Congress's enactment in 1989 of Section 502(*l*) which, as discussed above (at pp. 18-20), authorizes a civil penalty against parties in interest who engage in prohibited transactions in circumstances where the Secretary has obtained a recovery in a settlement or a civil action brought by the Secretary under Section 502(a)(5).

The text of Section 502(*l*) presupposes that the Secretary has authority to bring a civil action against a nonfiduciary party in interest who engages in a prohibited transaction.

The legislative history of the 1989 amendment shows that Congress declined to enact a separate provision in the House bill that was intended to clarify that a third party generally could be liable for knowing participation in a fiduciary breach. H.R. Rep. No. 247, 101st Cong., 2d Sess. 77 (1989). There was no suggestion, however, that any clarification was necessary regarding the availability of civil actions against nonfiduciary parties in interest that participate in prohibited transactions, which had been recognized by the courts. To the contrary, the Report noted that the Committee proposed the amendment because a divided panel of the Ninth Circuit had recently held in *Nieto* v. *Ecker*, 845 F.2d 868 (1988), that a court could not order a remedy against a nonfiduciary, "except to the extent that the non-fiduciary engaged in a transaction specifically prohibited by section 406 of ERISA as a party in interest." H.R. Rep. No. 247, *supra*, at 77. See *Nieto*, 845 F.2d at 873-874 (holding that plaintiffs stated a cause of action under Section 502(a)(3) against a nonfiduciary party in interest that engaged in a prohibited transaction).

Moreover, the Conference Report accompanying the enactment of Section 502(*l*) reinforced ERISA's emphasis on restoring the financial strength of the plan. The Report stated that "the conferees expect that in all circumstances the Department of Labor will take all necessary actions to restore assets lost to the plan as a result of a fiduciary breach." H.R. Conf. Rep. No. 386, 101 Cong., 2d Sess. 432 (1989). The Report also emphasized ERISA's policy of encouraging enforcement by both the Secretary and private parties through both administrative and judicial measures:

> The conferees believe strengthened civil penalties will better enable the Department to protect participants and beneficiaries. The conferees further believe that the

> need for strengthened enforcement and deterrence of violations of ERISA applies not only to the Department of Labor, but to judicial oversight of private rights of action affecting employee benefit plans. It remains the intent of Congress that the courts use their power [to] fashion legal and equitable remedies that not only protect participants and beneficiaries but deter violations of the law as well. The conferees expect that the executive agencies and the courts will use their substantial authority to achieve these goals and to safeguard the rights of plan participants.

Id. at 432-433. The enactment of Section 502(*l*) in 1989 therefore once again confirmed that a judicial order requiring a party in interest to make restitution to the plan of assets or profits it realized through a prohibited transaction with the plan constitutes "appropriate equitable relief" to redress such a violation of ERISA.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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APPENDIX

1. Section 502 of Employee Retirement Income Security Act of 1974, 29 U.S.C. 1132 (1994 & Supp. III 1997), provides, in relevant part:

Civil enforcement

(a) Persons empowered to bring a civil action

A civil action may be brought—

(1) by a participant or beneficiary—

(A) for the relief provided for in subsection (c) of this section, or

(B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan;

(2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title;

(3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan;

(4) by the Secretary, or by a participant, or beneficiary for appropriate relief in the case of a violation of 1025(c) of this title;

(5) except as otherwise provided in subsection (b) of this section, by the Secretary (A) to enjoin any act or practice which violates any provision of this subchapter, or (B) to obtain other appropriate equitable relief (i) to redress such violation or (ii) to enforce any provision of this subchapter;

(6) by the Secretary to collect any civil penalty under paragraph (2), (4), (5), or (6) of subsection (c) of this section or under subsection (i) or (l) of this section;

(7) by a State to enforce compliance with a qualified medical child support order (as defined in section 1169(a)(2)(A) of this title);

(8) by the Secretary, or by an employer or other person referred to in section 1021(f)(1) of this title, (A) to enjoin any act or practice which violates subsection (f) of section 1021 of this title, or (B) to obtain appropriate equitable relief (i) to redress such violation or (ii) to enforce such subsection; or

(9) in the event that the purchase of an insurance contract or insurance annuity in connection with termination of an individual's status as a participant covered under a pension plan with respect to all or any portion of the participant's pension benefit under such plan constitutes a violation of part 4 of this title[1] or the terms of the plan, by the Secretary, by any individual who was a

[1] So in original. Probably should be "subtitle".

participant or beneficiary at the time of the alleged violation, or by a fiduciary, to obtain appropriate relief, including the posting of security if necessary, to assure receipt by the participant or beneficiary of the amounts provided or to be provided by such insurance contract or annuity, plus reasonable prejudgment interest on such amounts.

* * * * *

(i) Administrative assessment of civil penalty

In the case of a transaction prohibited by section 1106 of this title by a party in interest with respect to a plan to which this part applies, the Secretary may assess a civil penalty against such party in interest. The amount of such penalty may not exceed 5 percent of the amount involved in each such transaction (as defined in section 4975(f)(4) of title 26) for each year or part thereof during which the prohibited transaction continues, except that, if the transaction is not corrected (in such manner as the Secretary shall prescribe in regulations which shall be consistent with section 4975(f)(5) of title 26) within 90 days after notice from the Secretary (or such longer period as the Secretary may permit), such penalty may be in an amount not more than 100 percent of the amount involved. This subsection shall not apply to a transaction with respect to a plan described in section 4975(e)(1) of title 26.

* * * * *

(l) Civil penalties on violations by fiduciaries

(1) In the case of—

(A) any breach of fiduciary responsibility under (or other violation of) part 4 of this subtitle by a fiduciary, or

(B) any knowing participation in such a breach or violation by any other person,

the Secretary shall assess a civil penalty against such fiduciary or other person in an amount equal to 20 percent of the applicable recovery amount.

(2) For purposes of paragraph (1), the term "applicable recovery amount" means any amount which is recovered from a fiduciary or other person with respect to a breach or violation described in paragraph (1)—

(A) pursuant to any settlement agreement with the Secretary, or

(B) ordered by a court to be paid by such fiduciary or other person to a plan or its participants and beneficiaries in a judicial proceeding instituted by the Secretary under subsection (a)(2) or (a)(5) of this section.

(3) The Secretary may, in the Secretary's sole discretion, waive or reduce the penalty under paragraph (1) if the Secretary determines in writing that—

(A) the fiduciary or other person acted reasonably and in good faith, or

(B) it is reasonable to expect that the fiduciary or other person will not be able to restore all losses to the plan (or to provide the relief ordered pursuant to subsection (a)(9) of this section) without severe financial hardship unless such waiver or reduction is granted.

(4) The penalty imposed on a fiduciary or other person under this subsection with respect to any transaction shall be reduced by the amount of any penalty or tax imposed on such fiduciary or other person with respect to such transaction under subsection (i) of this section and section 4975 of title 26.

2. Section 3003 of ERISA, 29 U.S.C. 1203, provides:

Procedures in connection with prohibited transactions

(a) Notification to Secretary of Labor; opportunity to comment on imposition of tax under Section 4975 of title 26; waiver; requests for invertigations

Unless the Secretary of the Treasury finds that the collection of a tax is in jeopardy, in carrying out the provisions of section 4975 of title 26 (relating to tax on prohibited transactions) the Secretary of the Treasury shall, in accordance with the provisions of subsection (h) of such section, notify the Secretary of Labor before sending a notice of deficiency with respect to the tax imposed by subsection (a) or (b) of such section, and, in accordance with the provisions of subsection (h) of such section, afford the Secretary an opportunity to comment on the imposition of the tax in any case. The Secretary of the Treasury shall have authority to waive the imposition of the tax imposed under section 4975(b) in appropriate cases. Upon receiving a written request from the Secretary of Labor or from the

Pension Benefit Guaranty Corporation, the Secretary of the Treasury shall cause an investigation to be carried out with respect to whether the tax imposed by section 4975 of title 26 should be applied to any person referred to in the request.

(b) Consultation

The Secretary of the Treasury and the Secretary of Labor shall consult with each other from time to time with respect to the provisions of section 4975 of title 26 (relating to tax on prohibited transactions) and with respect to the provisions of subchapter I of this chapter relating to prohibited transactions and exemptions therefrom in order to coordinate the rules applicable under such standards.

(c) Transmission of information to Secretary of the Treasury

Whenever the Secretary of Labor obtains information indicating that a party-in-interest or disqualified person is violating section 1106 of this title, he shall transmit such information to the Secretary of the Treasury.

3. Section 4975 of Title 26 of the United States Code (1994 & Supp. III 1997) provides:

Tax on prohibited transactions

(a) Initial taxes on disqualified person.

There is hereby imposed a tax on each prohibited transaction. The rate of tax shall be equal to 15 percent of the amount involved with respect to the prohibited transaction for each year (or part thereof) in the taxable period. The tax imposed by this subsection shall be paid by any disqualified person who participates in the prohibited transaction (other than a fiduciary acting only as such).

(b) Additional taxes on disqualified person.

In any case in which an initial tax is imposed by subsection (a) on a prohibited transaction and the transaction is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount involved. The tax imposed by this subsection shall be paid by any disqualified person who participated in the prohibited transaction (other than a fiduciary acting only as such).

(c) Prohibited transaction.

(1) General rule.

For purposes of this section, the term "prohibited transaction" means any direct or indirect—

(A) sale or exchange, or leasing, of any property between a plan and a disqualified person;

(B) lending of money or other extension of credit between a plan and a disqualified person;

(C) furnishing of goods, services, or facilities between a plan and a disqualified person;

(D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;

(E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or

(F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

(2) Special exemption.

The Secretary shall establish an exemption procedure for purposes of this subsection. Pursuant to such procedure, he may grant a conditional or unconditional exemption of any disqualified person or transaction, orders of disqualified persons or transactions, from all or part of the restrictions imposed by paragraph (1) of this subsection. Action under this subparagraph may be taken only after consultation and coordination with the Secretary of Labor. The Secretary may not grant an exemption under this paragraph unless he finds that such exemption is—

(A) administratively feasible,

(B) in the interests of the plan and of its participants and beneficiaries, and

(C) protective of the rights of participants and beneficiaries of the plan.

Before granting an exemption under this paragraph, the Secretary shall require adequate notice to be given to interested persons and shall publish notice in the Federal Register of the pendency of such exemption and shall afford interested persons an opportunity to present views. No exemption may be granted under this paragraph with respect to a transaction described in subparagraph (E) or (F) of paragraph (1) unless the Secretary affords an opportunity for a hearing and makes a determination on the record with respect to the findings required under subparagraphs (A), (B), and (C) of this paragraph, except that in lieu of such hearing the Secretary may accept any record made by the Secretary of Labor with respect to an application for exemption under section 408(a) of title I of the Employee Retirement Income Security Act of 1974.

(3) Special rule for individual retirement accounts.

An individual for whose benefit an individual retirement account is established and his beneficiaries shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be an individual retirement account by reason of the application of section 408(e)(2)(A) or if section 408(e)(4) applies to such account.

(4) Special rule for medical savings accounts.

An individual for whose benefit a medical savings account (within the meaning of section 220(d)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if section 220(e)(2) applies to such transaction.

(5) Special rule for education individual retirement accounts.

An individual for whose benefit an education individual retirement account is established and any contributor to such account shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if section 530(d) applies with respect to such transaction.

(d) Exemptions.

Except as provided in subsection (f)(6), the prohibitions provided in subsection (c) shall not apply to—

(1) any loan made by the plan to a disqualified person who is a participant or beneficiary of the plan if such loan—

(A) is available to all such participants or beneficiaries on a reasonably equivalent basis,

(B) is not made available to highly compensated employees (within the meaning of section

414(q)) in an amount greater than the amount made available to other employees,

(C) is made in accordance with specific provisions regarding such loans set forth in the plan,

(D) bears a reasonable rate of interest, and

(E) is adequately secured;

(2) any contract, or reasonable arrangement, made with a disqualified person for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor;

(3) any loan to an[2] leveraged employee stock ownership plan (as defined in subsection (e)(7)), if—

(A) such loan is primarily for the benefit of participants and beneficiaries of the plan, and

(B) such loan is at a reasonable rate of interest, and any collateral which is given to a disqualified person by the plan consists only of qualifying employer securities (as defined in subsection (e)(8));

(4) the investment of all or part of a plan's assets in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if—

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[2] So in original. Probably should be "a".

(A) the plan covers only employees of such bank or other institution and employees of affiliates of such bank or other institution, or

(B) such investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or institution or affiliates thereof) who is expressly empowered by the plan to so instruct the trustee with respect to such investment;

(5) any contract for life insurance, health insurance, or annuities with one or more insurers which are qualified to do business in a State if the plan pays no more than adequate consideration, and if each such insurer or insurers is—

(A) the employer maintaining the plan, or

(B) a disqualified person which is wholly owned (directly or indirectly) by the employer establishing the plan, or by any person which is a disqualified person with respect to the plan, but only if the total premiums and annuity considerations written by such insurers for life insurance, health insurance, or annuities for all plans (and their employers) with respect to which such insurers are disqualified persons (not including premiums or annuity considerations written by the employer maintaining the plan) do not exceed 5 percent of the total premiums and annuity considerations written for all lines of insurance in that year by such insurers (not including premiums or

annuity considerations written by the employer maintaining the plan);

(6) the provision of any ancillary service by a bank or similar financial institution supervised by the United States or a State, if such service is provided at not more than reasonable compensation, if such bank or other institution is a fiduciary of such plan, and if—

(A) such bank or similar financial institution has adopted adequate internal safeguards which assure that the provision of such ancillary service is consistent with sound banking and financial practice, as determined by Federal or State supervisory authority, and

(B) the extent to which such ancillary service is provided is subject to specific guidelines issued by such bank or similar financial institution (as determined by the Secretary after consultation with Federal and State supervisory authority), and under such guidelines the bank or similar financial institution does not provide such ancillary service—

(i) in an excessive or unreasonable manner, and

(ii) in a manner that would be inconsistent with the best interests of participants and beneficiaries of employee benefit plans;

(7) the exercise of a privilege to convert securities, to the extent provided in regulations of the

Secretary, but only if the plan receives no less than adequate consideration pursuant to such conversion;

(8) any transaction between a plan and a common or collective trust fund or pooled investment fund maintained by a disqualified person which is a bank or trust company supervised by a State or Federal agency or between a plan and a pooled investment fund of an insurance company qualified to do business in a State if—

(A) the transaction is a sale or purchase of an interest in the fund,

(B) the bank, trust company, or insurance company receives not more than reasonable compensation, and

(C) such transaction is expressly permitted by the instrument under which the plan is maintained, or by a fiduciary (other than the bank, trust company, or insurance company, or an affiliate thereof) who has authority to manage and control the assets of the plan;

(9) receipt by a disqualified person of any benefit to which he may be entitled as a participant or beneficiary in the plan, so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as applied to all other participants and beneficiaries;

(10) receipt by a disqualified person of any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan,

but no person so serving who already receives full-time pay from an employer or an association of employers, whose employees are participants in the plan or from an employee organization whose members are participants in such plan shall receive compensation from such fund, except for reimbursement of expenses properly and actually incurred;

(11) service by a disqualified person as a fiduciary in addition to being an officer, employee, agent, or other representative of a disqualified person;

(12) the making by a fiduciary of a distribution of the assets of the trust in accordance with the terms of the plan if such assets are distributed in the same manner as provided under section 4044 of title IV of the Employee Retirement Income Security Act of 1974 (relating to allocation of assets);

(13) any transaction which is exempt from section 406 of such Act by reason of section 408(e) of such Act (or which would be so exempt if such section 406 applied to such transaction) or which is exempt from section 406 of such Act by reason of section 408(b)(12) of such Act;

(14) any transaction required or permitted under part 1 of subtitle E of title IV or section 4223 of the Employee Retirement Income Security Act of 1974, but this paragraph shall not apply with respect to the application of subsection (c)(1)(E) or (F); or

(15) a merger of multiemployer plans, or the transfer of assets or liabilities between multiemployer plans, determined by the Pension Benefit Guaranty

Corporation to meet the requirements of section 4231 of such Act, but this paragraph shall not apply with respect to the application of subsection (c)(1)(E) or (F).

(e) Definitions.

(1) Plan.

For purposes of this section, the term "plan" means—

(A) a trust described in section 401(a) which forms a part of a plan, or a plan described in section 403(a), which trust or plan is exempt from tax under section 501(a),

(B) an individual retirement account described in section 408(a),

(C) an individual retirement annuity described in section 408(b),

(D) a medical savings account described in section 220(d),

(E) an education individual retirement account described in section 530, or

(F) a trust, plan, account, or annuity which, at any time, has been determined by the Secretary to be described in any preceding subparagraph of this paragraph.

(2) Disqualified person.

For purposes of this section, the term "disqualified person" means a person who is—

(A) a fiduciary;

(B) a person providing services to the plan;

(C) an employer any of whose employees are covered by the plan;

(D) an employee organization any of whose members are covered by the plan;

(E) an owner, direct or indirect, of 50 percent or more of—

(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation,

(ii) the capital interest or the profits interest of a partnership, or

(iii) the beneficial interest of a trust or unincorporated enterprise,

which is an employer or an employee organization described in subparagraph (C) or (D);

(F) a member of the family (as defined in paragraph (6)) of any individual described in subparagraph (A), (B), (C), or (E);

(G) a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of—

(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,

(ii) the capital interest or profits interest of such partnership, or

(iii) the beneficial interest of such trust or estate,

is owned directly or indirectly, or held by persons described in subparagraph (A), (B), (C), (D), or (E);

(H) an officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10 percent or more shareholder, or a highly compensated employee (earning 10 percent or more of the yearly wages of an employer) of a person described in subparagraph (C), (D), (E), or (G); or

(I) a 10 percent or more (in capital or profits) partner or joint venturer of a person described in subparagraph (C), (D), (E), or (G).

The Secretary, after consultation and coordination with the Secretary of Labor or his delegate, may by regulation prescribe a percentage lower than 50 percent for

subparagraphs (E) and (G) and lower than 10 percent for subparagraphs (H) and (I).

(3) Fiduciary.

For purposes of this section, the term "fiduciary" means any person who—

(A) exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,

(B) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or

(C) has any discretionary authority or discretionary responsibility in the administration of such plan.

Such term includes any person designated under section 405(c)(1)(B) of the Employee Retirement Income Security Act of 1974.

(4) Stockholdings.

For purposes of paragraphs (2)(E)(i) and (G)(i) there shall be taken into account indirect stockholdings which would be taken into account under section 267(c), except that, for purposes of this paragraph, section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).

(5) Partnerships; trusts.

For purposes of paragraphs (2)(E)(ii) and (iii), (G)(ii) and (iii), and (I) the ownership of profits or beneficial interests shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) (other than paragraph (3) thereof), except that section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).

(6) Member of family.

For purposes of paragraph (2)(F), the family of any individual shall include his spouse, ancestor, lineal descendant, and any spouse of a lineal descendant.

(7) Employee stock ownership plan.

The term "employee stock ownership plan" means a defined contribution plan—

(A) which is a stock bonus plan which is qualified, or a stock bonus and a money purchase plan both of which are qualified under section 401(a), and which are designed to invest primarily in qualifying employer securities; and

(B) which is otherwise defined in regulations prescribed by the Secretary.

A plan shall not be treated as an employee stock ownership plan unless it meets the requirements of section 409(h), section 409(o), and, as applicable, section 409(n) and section 664(g) and, if the employer has a registration-type class of

securities (as defined in section 409(e)(4)), it meets the requirements of section 409(e).

(8) Qualifying employer security.

The term "qualifying employer security" means any employer security within the meaning of section 409(l). If any moneys or other property of a plan are invested in shares of an investment company registered under the Investment Company Act of 1940, the investment shall not cause that investment company or that investment company's investment adviser or principal underwriter to be treated as a fiduciary or a disqualified person for purposes of this section, except when an investment company or its investment adviser or principal underwriter acts in connection with a plan covering employees of the investment company, its investment adviser, or its principal underwriter.

(9) Section made applicable to withdrawal liability payment funds.

For purposes of this section—

(A) In general.

The term "plan" includes a trust described in section 501(c)(22).

(B) Disqualified person.

In the case of any trust to which this section applies by reason of subparagraph (A), the term "disqualified person" includes any person who is a disqualified person with respect to any plan to which such trust is permitted

to make payments under section 4223 of the Employee Retirement Income Security Act of 1974.

(f) Other definitions and special rules.

For purposes of this section—

(1) Joint and several liability.

If more than one person is liable under subsection (a) or (b) with respect to any one prohibited transaction, all such persons shall be jointly and severally liable under such subsection with respect to such transaction.

(2) Taxable period.

The term "taxable period" means, with respect to any prohibited transaction, the period beginning with the date on which the prohibited transaction occurs and ending on the earliest of—

(A) the date of mailing a notice of deficiency with respect to the tax imposed by subsection (a) under section 6212,

(B) the date on which the tax imposed by subsection (a) is assessed, or

(C) the date on which correction of the prohibited transaction is completed.

(3) Sale or exchange; encumbered property.

A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

(4) Amount involved.

The term "amount involved" means, with respect to a prohibited transaction, the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the other property received; except that, in the case of services described in paragraphs (2) and (10) of subsection (d) the amount involved shall be only the excess compensation. For purposes of the preceding sentence, the fair market value—

(A) in the case of the tax imposed by subsection (a), shall be determined as of the date on which the prohibited transaction occurs; and

(B) in the case of the tax imposed by subsection (b), shall be the highest fair market value during the taxable period.

(5) Correction.

The terms "correction" and "correct" mean, with respect to a prohibited transaction, undoing the transaction to the extent possible, but in any case placing the plan in a financial position not worse than that in which it would be if the disqualified person were acting under the highest fiduciary standards.

(6) Exemptions not to apply to certain transactions.

(A) In general.

In the case of a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(3)), the exemptions provided by subsection (d) (other than paragraphs (9) and (12)) shall not apply to a transaction in which the plan directly or indirectly—

(i) lends any part of the corpus or income of the plan to,

(ii) pays any compensation for personal services rendered to the plan to, or

(iii) acquires for the plan any property from, or sells any property to,

any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or any corporation in which any such owner-employee owns, directly or indirectly, 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

(B) Special rules for shareholder-employees, etc.

(i) In general.

For purposes of subparagraph (A), the following shall be treated as owner-employees:

(I) A shareholder-employee.

(II) A participant or beneficiary of an individual retirement plan (as defined in section 7701(a)(37)).

(III) An employer or association of employees which establishes such an individual retirement plan under section 408(c).

(ii) Exception for certain transactions involving shareholder-employees.

Subparagraph (A)(iii) shall not apply to a transaction which consists of a sale of employer

securities to an employee stock ownership plan (as defined in subsection (e)(7)) by a shareholder-employee, a member of the family (as defined in section 267(c)(4)) of such shareholder-employee, or a corporation in which such a shareholder-employee owns stock representing a 50 percent or greater interest described in subparagraph (A).

(C) Shareholder-employee.

For purposes of subparagraph (B), the term "shareholder-employee" means an employee or officer of an S corporation who owns (or is considered as owning within the meaning of section 318(a)(1)) more than 5 percent of the outstanding stock of the corporation on any day during the taxable year of such corporation.

(g) Application of section.

This section shall not apply—

(1) in the case of a plan to which a guaranteed benefit policy (as defined in section 401(b)(2)(B) of the Employee Retirement Income Security Act of 1974) is issued, to any assets of the insurance company, insurance service, or insurance organization merely because of its issuance of such policy;

(2) to a governmental plan (within the meaning of section 414(d)); or

(3) to a church plan (within the meaning of section 414(e)) with respect to which the election provided by section 410(d) has not been made.

In the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of such plan shall be deemed to include such security but shall not, by reason of such investment, be deemed to include any assets of such company.

(h) Notification of Secretary of Labor.

Before sending a notice of deficiency with respect to the tax imposed by subsection (a) or (b), the Secretary shall notify the Secretary of Labor and provide him a reasonable opportunity to obtain a correction of the prohibited transaction or to comment on the imposition of such tax.

(i) Cross reference.

For provisions concerning coordination procedures between Secretary of Labor and Secretary of the Treasury with respect to application of tax imposed by this section and for authority to waive imposition of the tax imposed by subsection (b), see section 3003 of the Employee Retirement Income Security Act of 1974.